



Farmers and Merchants Bank of Long Beach
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Compliance Department
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Board of Governors of the Federal Reserve System
Robert deV. Frierson, Secretary
20th Street & Constitution Avenue NW
Washington, DC 20551

January 6, 2017

Re: Docket No. R-1549; RIN 7100 AE 60
Loans in Areas Having Special Flood Hazards – Private Insurance

Dear Robert deV. Frierson:

On behalf of Farmers and Merchants Bank of Long Beach ("F&M"), thank you for the opportunity to submit this comment in response to the Interagency request for comment on the proposed amendment to the regulations regarding loans in areas having special flood hazards to implement the private flood insurance provisions of the Biggert-Waters Flood Insurance Reform Act of 2012 (Biggert-Waters Act).

F&M is a community bank in southern California with \$6 billion in assets, 24 full service branches, and 2 loan production offices. F&M has been providing financial services to Los Angeles and Orange counties since 1907. As a community bank, F&M offers a broad range of consumer and business products and services including, but not limited to, demand deposit and time accounts, online banking, safe deposit boxes, escrow services, credit cards, residential mortgages, home equity lines of credit, and commercial real estate loans.

To better serve clients with collateral properties requiring flood insurance due to their location in a special flood hazard area, F&M began accepting private flood insurance policies in 2014. While this approach has enabled our clients to obtain more affordable flood insurance, it has been fraught with challenges for the clients and F&M. Specifically, ensuring that a policy meets FEMA's six criteria for conforming to the mandatory flood insurance purchase requirements involves an added cost of time and money due to the level of review necessary. The time involved with the initial policy review generally takes up to 5 business days and includes a detailed review of the policy and a review of those findings. However, when issues are identified with the policy's compliance that time is extended and has taken up to 4 weeks in multiple situations. Costs include a policy review fee paid by the client each time a private policy is received or renewed for a word-by-word comparison and/or review by a subject matter expert; and F&M staff costs for reviewing those findings. When items are found noncompliant, F&M staff costs are increased due to the additional time needed to address them. Clients also incur costs due to the time they must spend to address the issues and may also incur additional review costs if a private policy is obtained from a different insurance company and/or costs associated with funding delays. For example, a client may continue to pay a higher rate of interest on a loan with another financial institution if the refinance with F&M is delayed due to a noncompliant private flood policy.

Definition of Private Flood Insurance

Our key area of concern pertains to ensuring that policies meet Item #2 of the proposed definition of “private flood insurance” which states that the policy “Provides flood insurance coverage that is at least as broad as the coverage provided under a standard flood insurance policy (SFIP), including when considering deductibles, exclusions, and conditions offered by the insurer.” While the proposal to clarify the meaning of “at least as broad as” is helpful, Item #6 stating that the policy “does not contain conditions that narrow the coverage that would be provided in an SFIP” is extremely broad as it applies to terms throughout the entire policy, endorsements, and exhibits. Because of this, there will continue to be a need for a subject matter expert review and/or a word-by-word comparison of all policy documents to the comparable SFIP to ensure that the condition is met.

Compliance Aid

Unfortunately, we do not feel that the proposed compliance aid provision will assist in this area as intended based on experience with certifications being used at this time. Reasons for this are as follows:

1. When addressing the breadth of coverage, companies have simply stated that the policy is as broad as the coverage provided under an SFIP, including when considering deductibles, exclusions, and conditions offered by the insurer. We have never found that to be true in any instance that a certification was provided.
2. It has been our experience on multiple occasions that the insurance agent has a completely different understanding of the meaning of one or more of the criteria which must be met. For example:
 - a. A policy with a coinsurance clause was identified as being “as broad as” an SFIP although the coinsurance clause may limit coverage based on various factors; and
 - b. Multiple nonadmitted surplus line insurers have insisted that they meet the licensure criteria for residential property located in California although this does not appear to be true based on California Insurance Code¹.

This has caused an added cost of time and money. It has also been frustrating for all involved, especially the client, as they become caught in the middle between F&M and the insurance agent.

3. It is not unusual to find private policies with coverage which is not “as broad as” that in a comparable SFIP. Without a safe harbor and/or guidance on differences, finding and addressing them can be challenging and result in time and monetary costs. Examples of situations with language not being “as broad as” an SFIP are noted below. As shown, the degree of noncompliance varied greatly.
 - a. A private policy had limited insurance for food in freezers in comparison to an SFIP. However, the collateral property was not a restaurant or a business requiring refrigeration of any kind;
 - b. A private policy had a coinsurance clause which limited coverage in comparison to an SFIP. While coverage was limited based on the language alone, coverage may not have been limited from a monetary standpoint based on the amount of coverage obtained; and

¹ California Insurance Code > Division 1. General Rules Governing Insurance > Part 2. The Business of Insurance > Chapter 6. Surplus Line Brokers > Section 1776 states “The permission granted in this chapter to place any insurance in a nonadmitted insurer shall not be deemed or construed to authorize any insurer to do business in this state.”

- c. A private policy had a separate endorsement stating that covered property located in a Special Flood Hazard Area would not be covered for damage caused by flood.
- 4. Because the compliance aid will not provide a safe harbor, F&M and our clients will continue to face time and monetary costs due to the need to have the policy reviewed by a subject matter expert and/or have a word-by-word comparison made of all policy documents to the comparable SFIP to ensure that the policy meets the "as broad as" requirement. It is our understanding that word-by-word comparisons to the comparable SFIPs are being conducted by examiners during examinations of financial institutions accepting private policies and that few, if any, policies have been identified as compliant. Continuing forward in this vein, we anticipate that the regulatory agencies will experience additional time and monetary costs to a much larger degree once acceptance of private policies is required.

Recommendation

More recently, we've been receiving private policies with a Statement of Conformity and respectfully recommend that this approach be utilized as a safe harbor. An example of this language is as follows:

National Flood Insurance Act (Act) 1968 Statement of Conformity: Where flood is a covered peril under this policy and a section of this policy does not conform to the provisions of the Act, including subsequent Federal legislation replacing or adding to the Act, Underwriters agree in advance that this policy shall conform to be in compliance.

If proactive language can be included which results in a conforming policy, financial institutions will have a safe harbor and the time and monetary costs involved with a full document review would be eliminated.

Thank you in advance for your consideration of our comments.

Sincerely yours,
FARMERS AND MERCHANTS BANK

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